1031 DST Exchange overview

Purpose

Wealth Management

1031 DST Exchange funds can offer customized solutions for you to help defer taxes while diversifying real estate holdings.

Opportunity

Can provide you with an opportunity if you:

- Own investment real estate with significant built-in gains that must be reported as ordinary income
- Are hesitant to sell because of high tax implications
- Have depreciated real estate for many years, leaving little to no basis remaining
- Are tired of actively managing your investment property
- Are looking to create an estate or tax planning strategy

1031 DST Exchange Fund

Retain the primary tax-deferral advantages of a 1031 Exchange while providing the opportunity for:

- Consistent passive income from a master lease
- Diversification via access to a multi-billion-dollar portfolio of professionally managed real estate across the country

Benefits and considerations

Pros:

- Defer capital gains and recapture tax
- Maintain real estate exposure but are no longer responsible for active property management
- Gain liquidity and divisibility
- Receive access to diversified high-quality real estate

Cons:

- 1031 Exchanges would not allow the client to take out money and put it back into real estate tax free
- Client assets are illiquid for the first two years of entering the 1031 Exchange fund

1031 Exchange requirements and process

Examples of eligible properties

- Rental property
- Apartment buildings
- Farmland or land
- Hotels
- Business property
- Delaware statutory trusts (DST)

Sale of relinquished property →

1. Engage qualified intermediary	2. Sale of the property
A qualified intermediary must be engaged prior to the closing of the relinquished property	Sell property to a buyer of your selection

Identification period (45 days) →

Exchange period (180 days) →

3. Exchange account established	4. Identify new property	5. Reinvest in new property
The qualified intermediary holds the proceeds of the property sale until the replacement property is purchased	Replacement property is identified within 45 days of the sale	Net proceeds are used to acquire replacement property within 180 days of the sale

What is a Qualified Intermediary (QI)?	A QI facilitates the 1031 transaction and holds the proceeds to comply with IRC Section 1031. City National Bank can provide QI services if you don't know a QI.

What happens next — 721 Exchange

Once you have selected the replacement property and invested your net proceeds into the DST, you can UPREIT your fractional investment shares through a 721 Exchange to receive operating partnership units in the underlying REIT.

1 DST Exchange — fractional investment

- Investor purchases DST interest in syndicated property via their proceeds from their initial property
- Investor now has fractional investment shares of the syndicated property

2 After two years

- The fractional investment must be held for enough time (typically two years) to keep the 1031 Exchange intact
- The investment may pay dividends out to the investor during this period (typically 4% to 6% of NAV)

3 REIT shares ownership

- After the two-year period, the investor's fractional investment is exercised to REIT Operating Partnership (OP) shares via a 721 Exchange
- The underlying REIT is associated with the fund manager and known prior to 1031 Exchange process

4 One-year soft lock

- After a specific hold (typically one year), investors have the following options with their REIT OP units:

1. Hold shares and defer taxable event while receiving income (46%) and appreciation through a diversified and intuitionally managed portfolio
2. Can be used for estate planning/gifting
3. Also offers liquidity if necessary (taxable event)

Things to know about 1031 Exchanges

- Completing a 1031 Exchange investment can be a complicated transaction. We recommend reaching out to your financial advisor and tax professional early in the process. They can help verify all requirements are met so you are prepared for the transaction.
- These conversations can take place long before you plan to sell your property investment. Your team of professionals can help assess whether 1031 Exchanges or other options are most suitable for your needs and goals.

Investor scenario

Imagine one of your clients manages $60 million in commercial real estate and their situation is as follows:

- Neither the client's heirs or key employees want to manage the portfolio going forward.
- The client wants to maintain tax benefits and enjoy the income their portfolio generates.
- Client wants to simplify their estate and doesn't want to leave their heir(s) with a large tax bill.

How could a 1031 Exchange help in this situation? A 1031 Exchange fund could help accomplish several things:

- No longer having to personally manage tenants, leases, improvements, etc.
- Continue a steady stream of income.
- Provide liquidity at death, without worrying as much about the real estate market.
- Redeeming shares of the OP units rather than putting a property on the market.
- Easy division of assets to let the kids each decide what to do with their share without having to work together.
- However 1031 Exchanges would not allow the client to pull out money and put it back into real estate tax free
- Client assets are illiquid for the first two years of entering the 1031 Exchange fund

This scenario is for illustrative purposes and not intended to be representative of any specific investment vehicles.

Wealth Management

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24-70-01155_7075 (12/24)